INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute involved	2
Statement	3
Argument	8
Conclusion	13

CITATIONS

Cases:

Securities and Exchange Commission v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344	10
Securities and Exchange Commission v. *Capital Gains Bureau*, 375 U.S. 180	10
Tcherepnin v. *Knight*, 389 U.S. 332	10

Statutes:

Administrative Procedure Act, now 5 U.S.C. (Supp. V) 552, *et seq.*	7, 8
Securities Exchange Act of 1934:	
Section 6(a), 15 U.S.C. 78f(a)	3
Section 19(b), 15 U.S.C. 78s(b)	2, *passim*
Section 21(a), 15 U.S.C. 78u(a)	10

Miscellaneous:

H. Rep. No. 2337, 89th Cong., 2d Sess (1966), Securities and Exchange Commission, *Public Policy Implications of Investment Company Growth*	5-6
Securities Exchange Act Release No. 8239 (January 26, 1968)	11-12
Securities Exchange Act Release No. 8324 (May 28, 1968)	5, 9-10, 12
Securities Exchange Act Release No. 8382 (August 9, 1968)	12

In the Supreme Court of the United States

OCTOBER TERM, 1971

No. 70-232

INDEPENDENT BROKER-DEALERS' TRADE ASSOCIATION, ET AL., PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 2a-36a) is reported at 442 F. 2d 132. The oral opinion of the district court (Pet. App. 37a-39a) has not been reported.

JURISDICTION

The judgment of the court of appeals was entered on March 4, 1971. The petition for a writ of certiorari was filed on June 2, 1971. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Securities and Exchange Commission acted within its authority under Section 19(b) of the Securities Exchange Act when, after having requested the New York Stock Exchange to "effect on its own behalf" certain changes in its commission-rate structure, it acquiesed, without holding a hearing, in certain changes in those rates effected by the Exchange, as well as in a related provision abolishing customer-directed "give-ups" (fee splitting unrelated to service performed) which the Commission had not specifically requested.

STATUTE INVOLVED

Section 19(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b), provides:

> The Commission is further authorized, if after making appropriate request in writing to a national securities exchange that such exchange effect on its own behalf specified changes in its rules and practices, and, after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested, and that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange, by rules or regulations or by order to alter or supplement the rules of such exchange (insofar as necessary or appropriate to effect such changes) in respect of such matters as (1) safeguards in respect of the financial responsibility of members and adequate provision against the evasion of financial

responsibility through the use of corporate forms or special partnerships; (2) the limitation or prohibition of the registration or trading in any security within a specified period after the issuance or primary distribution thereof; (3) the listing or striking from listing of any security; (4) hours of trading; (5) the manner, method, and place of soliciting business; (6) fictitious or numbered accounts; (7) the time and method of making settlements, payments, and deliveries and of closing accounts; (8) the reporting of transactions on the exchange and upon tickers maintained by or with the consent of the exchange, including the method of reporting short sales, stopped sales, sales of securities of issuers in default, bankruptcy or receivership, and sales involving other special circumstances; (9) the fixing of reasonable rates of commission, interest, listing, and other charges; (10) minimum units of trading; (11) odd-lot purchases and sales; (12) minimum deposits on margin accounts; and (13) similar matters.

STATEMENT

1. Section 19(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. 78s(b), authorizes the Securities and Exchange Commission "by rules or regulations or by order to alter or supplement the rules of [a national securities] exchange[1]

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[1] Section 6(a) of the Exchange Act, 15 U.S.C. 78f(a), provides:

> Any exchange may be registered with the Commission as a national securities exchange * * * by filing a registration statement in such form as the Commission may prescribe * * *.

* * * in respect of such matters as * * * (9) the fixing of reasonable rates of commission * * * and (13) similar matters." The Commission may not act to alter or supplement the rules of an exchange under this provision, however, unless it has first made a written request to the exchange that it "effect on its own behalf [the] specified changes in its rules and practices, and, after appropriate notice and opportunity for hearing, the Commission determines that such exchange has not made the changes so requested * * *." In such circumstances the Commission can make the changes itself only if it determines, after the hearing, "that such changes are necessary or appropriate for the protection of investors or to insure fair dealing in securities traded in upon such exchange or to insure fair administration of such exchange * * *."

2. On May 28, 1968, the Commission wrote to the New York Stock Exchange (the "Exchange")

> * * * mak[ing] written request pursuant to Section 19(b) of the Securities Exchange Act that * * * [the] Exchange effect on its own behalf changes * * * in its rules, policies and practices in respect to its commission rate * * *. [Pet. App. 44a.]

The Commission proposed alternative changes: (1) a new rate structure incorporating reduced commission rates for most orders in excess of 400 shares; or (2) a rate structure eliminating minimum rates on all orders in excess of $50,000, thereby permitting negotiated rates on such orders (*ibid.*). The letter stated that "this request is intended as an interim

step and that the Commission has reached no definitive conclusion" whether the suggested commission rate schedule or "any schedule of specified rates" would provide a complete answer to commission-rate and related problems that the Commission had under consideration (*ibid.*). The Commission's letter added that: "[a]dditional measures with respect to other matters, including give-ups are under continuing consideration * * *."[2]

In response to the Commission's request, the Exchange, in letters dated August 8, 1968 (App. 35-42)[3] and August 20, 1968, replied that its Board of Governors believed that there was a need for an interim volume discount on large transactions, and, while the Commission's request had not specifically broached the subject, that there was also a need for abolition of customer-directed give-ups.[4]

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[2] A "give-up" occurs when a broker surrenders to another broker a portion of his commission on a transaction. The surrendered portion is referred to as the "give-up."

The May 28, 1968, letter was made public in a Commission release issued the same date, which also announced that the Commission had instituted a public investigation into the commission-rate structure of securities exchanges. Securities Exchange Act Release No. 8324. See n. 6 *infra* and accompanying text.

[3] "App." refers to the Appendix and "Supp. App." to Supplemental Appendix filed in the court of appeals.

[4] A "customer-directed" give-up is directed most frequently by the managers of institutional investors. A portion of the executing broker's commission is paid to one or more other brokers who ordinarily have not rendered any services in connection with the transaction being executed. See Securities and Exchange Commission, *Public Policy Implications of*

After soliciting comments on the Exchange's views (Supp. App. 25), the Commission advised the Exchange by letter dated August 30, 1968 (App. 51-53), that it would regard the Exchange's proposal, including the suggested abolition of give-ups, as an acceptable substitute which complied, in effect, with the first alternative proposed in the Commission's letter of May 28, 1968. The Board of Governors of the Exchange then adopted the proposals and, in accordance with its constitution, submitted them to its members for a vote. They were approved and became effective on December 5, 1968 (App. 68).

3. Petitioner Independent-Broker Dealers' Trade Association is a trade association composed of certain brokers and dealers in securities who are registered with the Commission and who are also members of the National Association of Securities Dealers, Inc., a na-

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Investment Company Growth, H. Rep. No. 2337, 89th Cong., 2d Sess. (1966), pp. 15-18 (The "*Mutual Fund Study*").

This practice developed, in part, as a result of the exchanges' minimum commission rate schedules, which did not provide for a volume discount on large securities transactions. *Id.* at 17. As the court of appeals noted (Pet. App. 4a), under the Exchange rate structure prior to the events complained of by petitioners, the commission on an order for 10,000 shares of a given security was exactly 100 times the commission for a 100 share order even though the brokers' expenses for execution were nowhere near 100 times as great. Because of the profitability of mutual fund commission business in the absence of a volume discount, many New York Stock Exchange members were willing to "give up" as much as 70 percent of the commission on these orders (*ibid.*). Customer-directed give-ups are to be distinguished from arrangements for sharing commissions between two brokers who have jointly participated in furnishing the services for which a commission is paid. *Mutual Fund Study, supra,* at 169-170.

tional securities association registered with the Commission, but who are not members of the Exchange. Petitioner James C. Butterfield, Inc., is a member of the Association.

Petitioners, claiming to have derived substantial income from customer-directed give-ups from Exchange members, filed suit in the district court against the Commission seeking declaratory and injunctive relief against what they characterized as a "direction or order" of the Commission that had resulted in the elimination of those give-ups (Supp. App. 5-12). They contended essentially that, under the Administrative Procedure Act and the Securities Exchange Act, they were entitled to a hearing before the Commission could take or require such action.

Upon the Commission's motions to dismiss and for summary judgment, the district court ruled (Pet. App. 38a) that the Commission's letter of August 30, 1968, "was, in effect, a suggestion to the Exchange that they should act in accordance with the alternatives which were being proposed." The court further found that, under Section 19(b), once the Commission accepted the "alternatives [proposed by the Exchange] in the public interest," it was not required to hold further hearings (Pet. App. 38a). It dismissed the action "for lack of jurisdiction" over the subject matter (Pet. App. 39a).

4. The court of appeals, one judge dissenting, ruled that the district court had erred in dismissing for lack of jurisdiction. The court, although recognizing that the Commission had not urged the abolition of customer-directed give-ups in its May 28 request, con-

cluded that the Commission had exerted "pressures" on the Exchange to prohibit such give-ups, which constituted "agency action" reviewable under the Administrative Procedure Act (Pet. App. 9a).[5]

On the merits, however, the court rejected petitioners' contentions and remanded the case with directions that the district court enter summary judgment in favor of the Commission. The court held that the Commission had acted within its statutory authority under Section 19(b) in making its request and that it had not improperly denied petitioners a hearing. It held that in reviewing the wisdom of "agency action" which fell short of a Section 19(ʊ) mandatory order, "[t]he most that the reviewing court can do is to decide whether there was some factual basis on which the Commission might reasonably believe" that certain Exchange practices should be changed, "and such basis will be presumed to exist unless negatived by the challenger" (Pet. App. 22a, 25a).

ARGUMENT

While we disagree with the holding of the court of appeals that the Commission's action here is subject to judicial review, we contend that court correctly concluded that the Commission acted within its authority and consistently with the procedural requirements of the Administrative Procedure Act and the Securities Exchange Act. There is, moreover, no con-

[5] Judge Robb, dissenting, would have affirmed the judgment of the district court essentially on the ground that the Exchange's action to abolish give-ups was voluntary (Pet. App. 26a-34a).

flict with other judicial decisions or other authority. Further review is not warranted.

1. The court of appeals correctly rejected as "patently frivolous" (Pet. App. 21a) petitioners' contention that the Commission's authority, under Section 19(b)(9) and (13) of the Securities Exchange Act, over "reasonable rates of commission" and "similar matters" does not encompass customer-directed give-ups. The willingness of brokers to surrender a substantial portion of their commission on large-volume transactions to others obviously relates to issues concerning the reasonableness of the underlying commission rates. Further, the rules and practices of the Exchange concerning the division of commissions among brokers are clearly a part of the "rules of practice" of the Exchange "in respect of" commissions. The Commission's authority covers all such rules and practices, and not merely an unspecified portion of them. Thus, in the release which publicly announced that the Commission had requested the Exchange to effect changes in its commission-rate structure, the Commission noted that

> the practices, procedures and exchange rules relating to exchange commission rate structures involve a number of matters such as (i) commission rate levels for exchange members (intra-member rates) and for non-members, (ii) the services for which such commission rates pay and the costs allocated thereto, (iii) *give-ups and reciprocal practices among different categories of members and non-members*, (iv) membership by financial institutions, (v) economic access to exchange markets by non-member

broker-dealers, (vi) competition among exchanges and among exchanges and other markets, and (vii) the necessity for restrictions on access of exchange members to the third market. [Emphasis supplied].[6]

A narrow reading of Section 19(b), to exclude "give-ups" from Commission consideration would, moreover, be contrary to the settled principle that the federal securities laws are remedial statutes which are to be construed "not technically and restrictively but flexibly to effectuate [their] remedial purposes." *Securities and Exchange Commission* v. *Capital Gains Bureau*, 375 U.S. 180, 195; *Tcherepnin* v. *Knight*, 389 U.S. 332, 336. *Cf. Securities and Exchange Commission* v. *C. M. Joiner Leasing Corp.*, 320 U.S. 344, 351-352.

2. Petitioners' argument (Pet. 16) that they were deprived of the right to a hearing under Section 19(b) also is without merit. Under Section 19(b) the Commission is required to make an "appropriate request in writing" that an exchange effect changes in its rules. A hearing is required only if the Commission seeks to amend the rules of an exchange

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[6] Securities Exchange Act Release No. 8324 (May 28, 1968). In this public release, the Commission announced that it had instituted a public investigation pursuant to Section 21(a) of the Act, 15 U.S.C. 78u(a), to consider whether any long-term changes should be made in the rules, policies, practices and procedures of registered national securities exchanges respecting commission rate structures. The release stated that the hearing was being conducted "to assist the Commission in the discharge of its responsibility under Section 19(b) of the Exchange Act and other provisions of the securities laws" (App. 29).

after the exchange has failed to take requested action itself. In the instant case, the Exchange effected changes in its rules "on its own behalf" which the Commission found satisfactory; thus, there was no occasion for the Commission to initiate the formal procedures available under Section 19(b). As the court below noted (Pet. App. 21a-22a):

> Section 19(b) contemplates that the Commission may make Requests without following the formal procedures required in the case of Orders. * * * * [T]o hold that such action, falling short of an Order, requires absolute adherence to the procedures set forth in § 19(b) for a mandatory order, would be to eliminate the mechanism of informal agency action, and response thereto, that is fairly contemplated by § 19(b) itself. * * *

In any event, as the court below observed, petitioners had "ample opportunity" to submit their views concerning abolition of customer-directed give-ups to the Commission in connection with its informal consideration of the issue (Pet. App. 23a). This arose in connection with proposals by the Commission and the Exchange with respect to give-ups,[7] investi-

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[7] In a letter dated January 2, 1968, the Exchange had submitted for Commission comment a five-point proposal for revision of its commission rate structure, which included, among other things, a form of volume discount and continuation of customer-directed give-ups with a percentage limit. Instead of responding to the Exchange's proposal, the Commission issued a release on January 26, 1968 (App. 2-28), in which it published for comment both the Exchange's proposal and a proposed Rule 10b-10 under the Securities Exchange Act, which would have prohibited investment company managers from directing give-ups unless the benefits of the

gatory hearings ordered by the Commission,[8] and the Exchange's counter-proposal for abolition of give-ups.[9] Petitioners' amended complaint indicates that members of the Association took advantage of these opportunities (Supp. App. 8-9).

It is, therefore, clear, as the court ruled, that petitioners have not been denied their procedural rights.

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resulting division of compensation accrued to the investment company or its shareholders. The Commission recognized that the proposal of the Exchange, as well as its proposed rule, would have "significant impact upon New York Stock Exchange member firms, non-member broker-dealers, institutional investors, other exchanges and the public." Both proposals were published in order "to afford interested persons the opportunity not only to comment with respect to both * * * but to suggest, if they so desire[d] alternative means of dealing with the serious and difficult problems presented" (App. 3-4). Securities Exchange Act Release No. 8239 (January 26, 1968).

[8] Securities Exchange Act Release No. 8324 (May 28, 1968). See n. 6, *supra*.

[9] Securities Exchange Act Release No. 8382 (August 9, 1968).

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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